

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission)	
on its own motion)	
)	Docket No. 01-0705
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Reconciliation of Revenues collected under)	
Gas Adjustment Charges with Actual Costs)	
prudently incurred)	
)	
Illinois Commerce Commission)	
on its own motion)	
)	Docket No. 02-0067
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Proceeding to review Rider 4, Gas Cost, pursuant)	
to Section 9-244(c) of the Public Utilities Act)	
)	
Illinois Commerce Commission)	
on its own motion)	
)	Docket No. 02-0725
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Reconciliation of Revenues collected under)	
Gas Adjustment Charges with Actual Costs)	
prudently incurred)	

**NICOR GAS COMPANY'S
INITIAL BRIEF**

Dated: April 6, 2012

TABLE OF CONTENTS

	Page
I. INTRODUCTION	2
II. FACTUAL AND PROCEDURAL BACKGROUND.....	7
A. The Gas Cost Performance Program.....	7
B. Investigations of the GCPP	9
C. Restatement of Nicor Gas' 1999-2002 Results.....	10
D. Proceedings on Reopening.....	10
E. Stipulation with Staff	12
III. CONTESTED ISSUES	14
A. LIFO Benefit.....	16
B. Storage Carrying Charges	16
C. DSS Withdrawals.....	18
D. In-Field Storage Transfers	20
E. 2001 Storage Withdrawals.....	20
1. CUB and the AG Lack a Coherent Theory of Liability	22
2. The AG and CUB Claims Take an Impermissibly Narrow View of Customer Impacts	28
3. The AG and CUB Claims are Based on Assumptions, Not Evidence.....	29
4. The Low Year End 2000 Inventory Levels Were Part of a Nationwide Pattern, and in Nicor Gas' Case can be Explained by Factors Unrelated to the GCPP	33
5. Conclusion	41
F. Tennessee Gas Pipeline and Midwestern Gas Transmission Capacity Costs.....	41
G. Capacity Management Credits.....	42
H. Affiliate Below Market Sale	42
I. Aquila Weather Insurance.....	43
J. Hub Revenues	43
K. Refund Allocation	44
IV. CONCLUSION.....	44

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission)	
on its own motion)	
)	Docket No. 01-0705
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Reconciliation of Revenues collected under)	
Gas Adjustment Charges with Actual Costs)	
prudently incurred)	
)	
Illinois Commerce Commission)	
on its own motion)	
)	Docket No. 02-0067
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Proceeding to review Rider 4, Gas Cost, pursuant)	
to Section 9-244(c) of the Public Utilities Act)	
)	
Illinois Commerce Commission)	
on its own motion)	
)	Docket No. 02-0725
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Reconciliation of Revenues collected under)	
Gas Adjustment Charges with Actual Costs)	
prudently incurred)	

**NICOR GAS COMPANY'S
INITIAL BRIEF**

In accordance with the schedule established by the Administrative Law Judges (“ALJ”), Northern Illinois Gas Company d/b/a Nicor Gas Company (“Nicor Gas” or the “Company”) hereby files with the Illinois Commerce Commission (“Commission”) this Initial Brief following evidentiary hearings held on February 28 through March 1, 2012.

I. INTRODUCTION

On February 16, 2012, Nicor Gas and the Commission Staff (“Staff”) entered into a Stipulation (“Stipulation”) that resolved all issues as to which Staff asserted that Nicor Gas is liable for refunds in this proceeding. Nicor/Staff Ex. 1; Tr. 1471:4-1472:3. The Stipulation, which is based on the evidentiary record, provides that Nicor Gas will refund \$64 million to customers to resolve disputes about various transactions undertaken during 2000-2002 under the Gas Cost Performance Program (“GCPP”) approved by the Commission in November 1999. Staff recommends that this refund be returned to customers through the Company’s Purchased Gas Adjustment (“PGA”) Rider mechanism. Everson Dir., Staff Ex. 3.0, 18:346-19:369; Tr. 1290:22-1291:10; Tr. 1297:1-4. Nicor Gas has no objection to Staff’s proposal.

Given the result of the Stipulation, the evidentiary hearings demonstrated that only three issues remain to be considered concerning the operation of the GCPP. *See* Nicor Cross Ex. 1.0; Tr. 1107:6-1108:15, 1290:22-1298:18. Specifically, these issues are: (1) the claims by the Illinois Attorney General’s Office (“AG”) and the Citizens Utility Board (“CUB”) concerning Nicor Gas’ 2001 storage cycling; (2) CUB’s claim concerning alleged storage carrying charges; and (3) CUB’s claim regarding DSS storage withdrawals. Apart from these there is the Retail Energy Supply Association’s (“RESA”) claim concerning how any GCPP-related refund should be allocated. The AG and CUB claims are without merit and should be rejected. Meanwhile, RESA presented no testimony to support its unknown refund allocation methodology. The following briefly addresses these four issues, which are discussed more fully in Part III.

2001 Storage Cycle Claims: The AG’s witness, David Effron, and CUB’s witness, Jerome Mierzwa, offer complementary theories to claim that Nicor Gas improperly reduced its 2001 storage cycle, which allegedly harmed customers by requiring Nicor Gas to purchase gas on the open market. The AG seeks a maximum of \$181,879,000 in additional refunds on this

issue and CUB seeks \$155,320,932. Notably, despite a decade of litigation over the GCPP, Staff never raised this issue, nor did it support the AG's or CUB's claims.

These claims are not supported by any legal or regulatory theory of recovery that would justify the massive refunds sought. Moreover, it is evident that these claims are not based on actual facts, but instead on assumed or inferred "facts" that have no basis in the evidentiary record. Additionally, the assumptions underlying these hypothetical world claims are contradicted by real world explanations for what actually transpired. Here, the evidence demonstrates that the Company's physical storage operations in 2000 and 2001 were dictated by market conditions over which Nicor Gas had no control. Among the facts undermining the claims of the AG and CUB:

- Despite seeking almost \$200 million in refunds on this issue, AG witness Effron testified that "I am *not* accusing Nicor [Gas] of having acted imprudently or having manipulated anything or any wrongdoing," at any time relevant to this proceeding. Tr. 1342:19-1343:5 (emphasis added).
- Both AG witness Effron and CUB witness Mierzwa concede that Nicor Gas never paid more than the market price for gas. Tr. 1330:17-1331:2 (Effron); Tr. 1112:10-1113:12 (Mierzwa).
- CUB witness Mierzwa seeks to impose a prudence standard on the Company's actions even though *imprudence is not the standard by which Nicor Gas' actions during the GCPP period are to be judged*. The Commission's Order in Docket No. 99-0127, approving the GCPP, expressly rejected holding "prudence reviews" even if losses exceeded a threshold level. "Instead of the *traditional prudence review*, Section 9-244(c) requires that the Commission review the program two years after its implementation to determine whether it is meeting its objective." Order, Docket No. 99-0127, at 37 (Nov. 23, 1999) (emphasis added). The Commission undertook that review but, before it was completed, Nicor Gas voluntarily discontinued the GCPP.
- CUB witness Mierzwa's claim is based, in part, on the view that it was imprudent for Nicor Gas *to act in accordance with the Commission's Order* approving the GCPP during the fall of 2001. Tr. 1134:7-1135:5, 1147:11-22.
- Nicor Gas' inventory management decisions were affected by extraordinary events in the two key months underlying the AG and CUB claims –November and December 2000. At that time, the Nicor Gas service territory, and the nation,

experienced unusually cold weather which increased the demand for gas. Carpenter Reb., Nicor Gas Ex. 5.0R, 18:335-19:386. Coupled with an unforeseeable and unprecedented spike in natural gas prices, Nicor Gas reasonably relied on gas in storage to serve customers during that period. *See, e.g., id.* at 19:387-21:406; Moes/Gulick Sur., Nicor Gas Ex. 12.0R, 12:233-17:309. The resulting depletion of Nicor Gas' inventory is what caused Nicor Gas to rely on market purchases in 2001.

- Even though the operational aspects of system integrity and safety are indisputably complicated, neither the Mr. Effron nor Mr. Mierzwa has any experience in operating a gas storage field, nor does either have any experience in the highly complex business of managing gas supply operations to ensure the safe and reliable delivery of natural gas to customers. Tr. 1114:1-22 (Mierzwa); Tr. 1315:1-22 (Effron). Indeed, CUB witness Mierzwa concedes that such management is a complicated operation that if badly mismanaged can have catastrophic effects on the utility and its customers. Tr. 1114:8-22. Nor did the AG or CUB attempt to present the testimony of anyone with operational expertise to support their positions here.
- No party claims that Nicor Gas operated its storage fields or gas supply operations in a manner which threatened the safe and reliable delivery of natural gas to its customers.
- An extensive factual investigation of the GCPP by a team of attorneys and accountants led by the former United States Attorney for the Northern District of Illinois found that Nicor Gas did not manipulate its storage activities. CUB Ex. 1.02 Rev. at 52, n.24.
- Neither the United States Securities and Exchange Commission ("SEC") nor the United States Attorney's Office for the Northern District of Illinois, after examining GCPP issues for four years, ever made any claims that Nicor Gas manipulated its storage activities.¹
- Nicor Gas was the low-cost provider of natural gas among major Illinois gas utilities during the 3-year period the GCPP was in effect. *See* Gorenz Reb., Nicor Gas Ex. 3.0, 15:302-11 and Nicor Gas Ex. 3.1; Moes/Gulick Reb., Nicor Gas Ex. 7.0, 4:62-5:76.

In sum, the evidentiary record overwhelmingly demonstrates that the AG's and CUB's claims on this issue are baseless. Their positions reflect hindsight and conjecture, not facts.

¹ The Commission may take administrative notice of these facts pursuant to the Commission's Rules of Practice. 83 Ill. Adm. Code 200.640(a)(7).

Indeed, AG witness Effron does not even claim that Nicor Gas engaged in any wrongdoing or imprudent activity. Accordingly, the Commission should reject these claims.

Storage Carrying Charges: CUB witness Mierzwa claims that a refund of \$40,974,944 is required because Nicor Gas depleted certain layers of low-cost last-in first-out (“LIFO”) inventory layers and replaced it with higher cost layers. Neither the AG nor Staff proposed such a refund, and neither party supported CUB’s claim. In reality, CUB’s claim is not supported by the Public Utilities Act (“Act”), the Commission’s Rules, or the evidentiary record. Perhaps most significant, nothing that Nicor Gas did in this regard was impermissible under the terms of the GCPP Order.

CUB’s position is legally flawed. For example, CUB’s adjustment is completely inconsistent with the Commission’s acceptance of the LIFO methodology of accounting for gas in storage. *See, e.g.*, 83 Ill. Adm. Code 505.1170(C). In authorizing this practice, the Commission recognized that additional layers would be added to storage inventory with different prices. And nothing in the Act or the Commission’s Rules prohibits a utility from using gas in inventory. Staff witness Richard Zuraski agreed to this point. Tr. 1284:12-15. Further, nothing in the Act or the Commission’s Rules prohibits a utility from adding a LIFO layer of gas that is priced higher than a previous layer of gas. Again, Staff witness Zuraski agreed to this point. Tr. 1284:7-11. In addition, nothing in the Act or the Commission’s Rules even suggests that a utility should be penalized when it adds a LIFO layer of gas that is priced higher than prior layers. To the contrary, utilities routinely include in rate base higher cost assets that replace lower cost, depreciated assets.

Moreover, permitting CUB’s proposed adjustment on this point would require the Commission to re-calculate rates that it previously found just and reasonable in prior Nicor Gas

rate cases. For example, in Nicor Gas' 2004 rate case, the Commission found Nicor Gas' valuation of gas in storage, which included the cost of the 2003 incremental LIFO layer (the layer targeted by CUB), just and reasonable. Docket No. 04-0779, Order at 19 (Sept. 20, 2005). *See also* Docket No. 08-0363, Order (Mar. 25, 2009 and Oct. 7, 2009). To order refunds as CUB proposes would constitute improper single-issue and retroactive ratemaking. *See, e.g., Citizens Util. Bd. v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 136-37 (1995); *Citizens Utilities Co. v. Illinois Commerce Comm'n*, 124 Ill. 2d 195, 210-11 (1988).

CUB's position also is factually flawed. Specifically, the claim for storage inventory carrying costs implies that low-cost gas in storage should never be accessed because, by definition, it would always need to be replaced by higher-cost gas. Carpenter Reb., Nicor Gas Ex. 5.0R, 9:167-70. Indeed, CUB itself concedes the legitimacy of accessing low-cost inventory by claiming that the low-cost LIFO layers would have been accessed under traditional regulation for the benefit of ratepayers; indeed, customers will receive 100% of the value of the LIFO layers under the terms of the Stipulation. The Commission should reject CUB's attempt to have the best of both worlds by claiming that ratepayers should receive 100% of the benefits of the liquidation of the low-cost inventory and not have to bear the costs of a new LIFO layer that was added at the end of 2003, a year after the GCPP ended.

DSS Withdrawals: CUB witness Mierzwa claims a refund of \$8,149,519 related to Nicor Gas' delivered storage service ("DSS") storage withdrawal activity.² CUB Ex. 1.12. Specifically, Mr. Mierzwa argues that a correction is required due to certain allegedly "unaccounted for" withdrawals, which impact the Storage Credit Adjustment component of the

² Nicor Gas leases DSS capacity from a third party, Natural Gas Pipeline Company of America. DSS is not part of Nicor Gas' system of Company-owned aquifer storage fields.

GCPP Benchmark. AG witness Effron neither proposed this refund nor supported CUB's claim. Meanwhile, Staff withdrew its claim on this issue. Nicor/Staff Ex. 1.0 at ¶ 4. Mr. Mierzwa's claim flies in the face of the fact that Nicor Gas already has corrected (in its restated GCPP results) the prior treatment of its December 1999 sale/release of DSS to IMD Storage Management and Asset Transportation Company to account for its use of DSS (and NSS) storage between 2000 and 2002, and those restatements were accepted by Staff and Intervenors. Carpenter Reb., Nicor Gas Ex. 5.0R, 10:187-89, 35:671-72, 36:685-87. Moreover, Mr. Mierzwa again presents no facts to support this claim, but relies entirely on speculation, "supported" by fragmentary excerpts from two unidentified documents, that Nicor Gas and its auditors did not get the restatement right and allegedly missed some DSS storage withdrawals. *Id.* at 35:672-81; Carpenter Sur., Nicor Gas Ex. 10.0, 23:422-25:463.

Refund Allocation: RESA apparently disagrees with Staff's proposal to return the \$64 million refund through a credit applied through Nicor Gas' PGA Rider mechanism. *See, e.g.*, Tr. 1290:22-1298:18. However, RESA did not file any testimony explaining why Staff's proposal is incorrect or any testimony detailing RESA's proposed methodology. As such, Nicor Gas has not been given the opportunity to test whether RESA's unknown proposal is reasonable. Accordingly, the Company reserves the right to object and/or respond to any RESA proposal set forth in its Initial Brief.

II. FACTUAL AND PROCEDURAL BACKGROUND

A. The Gas Cost Performance Program

Pursuant to Section 9-244 of the Act, 220 ILCS 5/9-244, Nicor Gas developed an alternative rate regulation program under its former Rider 4, Gas Cost Performance Program ("Rider 4" or the "GCPP") and sought Commission approval of that program in early 1999. Bartlett Dir., Nicor Gas Ex. 1.0, 5:100-01. The Commission approved the GCPP, which became

effective on January 1, 2000, in an Order entered on November 23, 1999 in Docket No. 99-0127. *Id.* at 5:101-04; Docket No. 99-0127, Order (Nov. 23, 1999). Nicor Gas terminated Rider 4, effective December 31, 2002, and returned to traditional rate regulation. Bartlett Dir., Nicor Gas Ex. 1.0, 5:106-07.

Generally, the idea behind alternative rate regulation is to create incentives for utilities to deliver lower rates to customers than would be expected under traditional cost-recovery regulation. *Id.*, 3:55-58. The Company's former Rider 4 provided a mechanism to compare Nicor Gas' cost of gas, as determined by the Commission through the Company's annual reconciliation proceeding under Rider 6, Gas Cost Supply ("Rider 6"), with a computational benchmark ("Benchmark") that in theory approximated Nicor Gas' cost of gas in a fully regulated environment. *Id.* at 3:58-63. The difference, either positive or negative, was to be split 50/50 between Nicor Gas and its customers. *Id.* at 3:63-4:64. The Company's Rider 6 provided the mechanism for Nicor Gas to share results generated under Rider 4 with its customers. *Id.* at 4:64-65.

Importantly, the Commission-approved GCPP used the market-based Benchmark as a proxy for a prudence review. *See, e.g.*, Ill. C. C. No. 16-Gas, Original Sheet Nos. 55.7, 55.8, 55.9, 55.9.1 and 3rd Revised Sheet No. 62. The tariffs relating to the GCPP state, in pertinent part: "The Commission shall not consider the prudence of gas costs incurred for any period included in Rider 4, Gas Cost Performance Program." *Id.* at 3rd Revised Sheet No. 62. In addition, in approving Rider 4, the Commission specifically recognized that the Company's actions under the GCPP are not subject to a *post hoc* prudence review:

Instead of the traditional prudence review, Section 9-244(c) requires that the Commission review the program two years after its implementation to determine whether it is meeting its objective.

Docket No. 99-0127, Order at 37 (Nov. 23, 1999). Thus, on January 24, 2002, the Commission initiated its review of Rider 4, which is part of these consolidated proceedings. Docket No. 02-0067, Initiating Order (Jan. 24, 2002).

B. Investigations of the GCPP

In response to an anonymous facsimile relating to the operation of the GCPP received by CUB in June 2002, the Special Committee of the Board of Directors of Nicor Inc. retained former United States Attorney for the Northern District of Illinois Scott Lassar to conduct an investigation into the allegations in the facsimile. Bartlett Dir., Nicor Gas Ex. 1.0, 6:122-7:130. His investigation determined that certain accounting errors occurred in connection with the GCPP and recommended various corrections, as set forth in the October 28, 2002 Report to the Special Committee of the Board of Directors of Nicor Inc. (the “Lassar Report”).³ *Id.* at 7:132-33. The Lassar Report recommended that \$15.3 million in adjustments related to the operation of the GCPP be refunded to Nicor Gas’ customers. *Id.* at 7:144-45; CUB Ex. 1.02 Rev. at 2-6.

None of the Federal agencies, including the SEC and the United States Attorney’s Office for the Northern District of Illinois, that reviewed Nicor Gas’ actions under the GCPP found that the Company engaged in fraudulent or criminal activity—either in 1999 when Nicor Gas first proposed the GCPP to the Commission, or during the years that the GCPP was in effect. The Lassar Report expressly found:

Under the PBR [GCPP], Nicor [Gas] found itself operating in a new and highly complex regulatory environment that was intended to align the Company’s and ratepayers’ interests. We identified several instances in which the Company took actions that had the effect of benefiting the Company and disadvantaging ratepayers. In other instances, the Company made inadvertent accounting errors, sometimes to the benefit of the Company and sometimes to

³ The Lassar Report was admitted into evidence as CUB Exhibit 1.02 Revised.

the benefit of ratepayers. We did not find that there was criminal activity or fraud.

CUB Ex. 1.02 Rev. at 7. The Lassar Report also concluded that no evidence indicated that the total volume of gas storage withdrawals by Nicor Gas in 2001 was because of improper attempts to manipulate the storage cycle. *Id.* at 52, n.24. Indeed, the AG's only witness in this proceeding has admitted that he is not testifying that Nicor Gas "acted imprudently" or committed "any wrongdoing." Tr. 1343:1-3.

C. Restatement of Nicor Gas' 1999-2002 Results

Consistent with the Lassar Report's recommendations, in early 2003, Nicor Inc. submitted independently audited, restated financial results to the SEC, and Nicor Gas submitted its restated GCPP results for the years 1999-2001 to the Commission. Bartlett Dir., Nicor Gas Ex. 1.0, 7:147-8:164. Importantly, the SEC, the United States Attorney's Office for the Northern District of Illinois and a variety of civil litigants examined the restated results and found no errors.⁴ Nicor Inc.'s audited restated financial results, which include the restatement of the GCPP results, have never been disputed. *See id.* at 4:84-85.

It is these restated GCPP results for the years 1999-2001, as well as Nicor Gas' annual filings for the year 2002 under Riders 4 and 6, that have formed the basis of Nicor Gas' position and proposed adjustments throughout this proceeding. *See, e.g.*, Gorenz Dir., Nicor Gas Ex. 2.0, 2:24-36; Nicor Gas Exs. 2.1-2.5.

D. Proceedings on Reopening

Given the above-described events, Nicor Gas agreed with the other parties to reopen discovery in Docket No. 02-0067, and the Commission entered an Interim Order allowing same.

⁴ Again, these are facts as to which the Commission may take administrative notice. 83 Ill. Adm. Code 200.640(a)(7). *See also* Moes/Gulick Sur., Nicor Gas Ex. 12.0R, 3:47-49.

Bartlett Dir., Nicor Gas Ex. 1.0, 8:175-9:177. The Commission subsequently reopened the record in Docket No. 02-0067 in its Second Interim Order entered on December 17, 2002. *Id.* at 9:182-83. In that Order, the Commission stated that it was reopening the record to consider:

... all issues relating to the *operation* of the *Program* Nicor Gas implemented under tariffs filed in accordance with the Commission's Order entered November 23, 1999, in Docket 99-0127, and all issues relating to any refunds that may be owing to Nicor [Gas] customers as a result of the operation of the Program and as a result of the operation of the Company's Rider 6 in 1999, 2000, 2001, and 2002, and for ordering such other and further relief as deemed equitable and just.

Docket No. 02-0067, Second Interim Order at 6 (Dec. 17, 2002) (emphasis added). This Order did *not* set for consideration any issues relating to the *approval* of the GCPP or re-open in any way Docket No. 99-0127. At the same time, the Commission consolidated Docket No. 02-0067 with Nicor Gas' then-pending Rider 6 reconciliation proceedings for the years 2001 and 2002, which were designated as Dockets Nos. 01-0705 and 02-0725, respectively. Bartlett Dir., Nicor Gas Ex. 1.0, 9:183-86; Docket Nos. 01-0705, 02-0067, and 02-0725, Consolidated (the "Consolidated Proceedings").

After the record in Docket No. 02-0067 was reopened, Nicor Gas, Staff and the other parties conducted extensive discovery, including the discovery depositions of thirteen current or former Nicor Gas employees taken by Staff and Intervenors in June and July 2003. Staff selected the deponents, who included executives and management connected to the GCPP or the gas cost supply reconciliations that are the subject of this proceeding.⁵ CUB witness Mierzwa has testified that he personally developed questions for these depositions. Tr. 1180:14-22. Nicor

⁵ The deponents were Al Harms, Jeff Metz, Dave Brown, Beth Hohisel, George Behrens, Rose Gorman, Ted Lenart, Rich Rayappan, Phil Cali, Lonnie Upshaw, Kathleen Halloran, Len Gilmore, and Tom Fisher. See Staff's May 30 and July 22, 2003 Motions for Leave to Conduct Discovery Depositions and ALJs' Rulings of June 3 and July 23, 2003 granting same. See also Tr. 1155:10-15.

Gas, Staff and the other parties also pre-filed several rounds of testimony from August 2003 to March 2004. Bartlett Dir., Nicor Gas Ex. 1.0, 10:205-06.

Before evidentiary hearings scheduled for April 19, 2004 were able to begin, the proceedings were effectively suspended for more than two years for reasons outside the control of Nicor Gas or any of the other parties due to related litigation in the Cook County Circuit Court. *See, e.g., id.* at 10:208-11:238.

In April 2007, Nicor Gas filed the direct testimony of Gary Bartlett, Vice President Supply Operations, and James Gorenz, Assistant Controller. Nicor Gas Exs. 1.0 and 2.0. Staff and Intervenors filed their direct testimony in August 2009, some of which was the subject of a motion to strike filed by Nicor Gas. In May 2010, the ALJs granted Nicor Gas' motion in part, and Staff and Intervenors filed their revised direct testimony in November 2010. Nicor Gas, Staff and Intervenors filed rebuttal and surrebuttal testimony over the course of 2011. Evidentiary hearings were held from February 28 through March 1, 2012.

E. Stipulation with Staff

On February 16, 2012, Staff and Nicor Gas entered into the Stipulation, which resolved all issues⁶ in the Consolidated Proceedings, as well as Docket Nos. 99-0481 and 01-0718, to the extent the issues from those proceedings are implicated in the Consolidated Proceedings. The Stipulation, which was entered into evidence as Nicor/Staff Exhibit 1.0, details the evidence supporting resolution of all issues Staff has raised in the Consolidated Proceedings and demonstrates that Nicor Gas has no objection to refunding customers \$64 million, pursuant to the

⁶ As used in the Stipulation, the term "all issues" refers to all of the issues as to which Staff asserts that Nicor Gas is liable for refunds in the Consolidated Proceedings, but does not include the issue of how refunds will be allocated to customers. It also does not include any amount Nicor Gas was ordered to refund to retail customers by any other tribunal, including the Federal Energy Regulatory Commission (*see* "Order Approving Stipulation and Consent Agreement," issued March 14, 2003, set out in full as Staff Ex. 3.0, Attachment 1).

terms of the Stipulation. One of those terms was agreement between Nicor Gas and Staff that nothing in the Stipulation “constitutes an admission of liability or fault on the part of Nicor Gas.” Nicor/Staff Ex. 1.0, ¶ 7.

Specifically, Nicor Gas stipulated that it will not object to the Commission’s ordering of refunds (plus interest) based upon the following adjustments proposed by Staff, which form the basis for the stipulated refund:

(A)	LIFO derived savings ⁷ :	21,871,934
(B)	Storage credit adjustment ⁸ :	11,149,901
(C)	Reversal of costs from 2000 affiliate discount ⁹ :	4,258,586
(D)	Reversal of costs from 2001 weather insurance ¹⁰ :	2,057,525
(E)	Adjustment based on certain Hub revenues ¹¹ :	6,150,917
(F)	Revise benchmark to reflect contract costs ¹² :	1,475,267
(G)	Revise benchmark (capacity management) ¹³ :	5,893,472
(H)	Capacity management adjustment (1999) ¹⁴ :	<u>3,216,169</u>
Total		\$56,073,771

Nicor/Staff Ex. 1.0. Further, as part of the Stipulation, and based upon consideration of all evidence, Staff withdrew the other recommended adjustments in its testimony, including the adjustment concerning managed DSS withdrawals (*see* Staff Ex. 1.0R, 36:741-38:794) and

⁷ See Staff Ex. 1.0R, 5:102-6:121 and 10:212-23:458; *see also* Staff Ex. 5.0, 6:72-11:197.

⁸ See Staff Ex. 1.0R, 6:122-26, 23:459-25:498 and 26:521-36:739; *see also* Staff Ex. 5.0, 11:198-13:229.

⁹ See Staff Ex. 1.0R, 7:141-50 and 39:795-42:856; *see also* Staff Ex. 5.0, 14:256-17:318.

¹⁰ See Staff Ex. 1.0R, 7:151-8:160 and 42:857-44:894; *see also* Staff Ex. 5.0, 17:319-19:364.

¹¹ See Staff Ex. 1.0R, 8:176-9:182 and 47:955-50:1011; *see also* Staff Ex. 5.0, 19:365-21:435.

¹² See Staff Ex. 2.0R, 3:42-46, 4:54-55 (including Table 1) and 23:435-28:517 (including Tables 2 and 3).

¹³ See Staff Ex. 2.0R, 3:47-50, 4:54-55 (including Table 1) and 28:518-37:685 (including Table 4).

¹⁴ See Staff Ex. 2.0R, 3:47-50, 4:54-55 (including Table 1) and 28:518-37:685 (including Table 4).

carrying charges associated with the managed DSS withdrawals (*see* Staff Ex. 1.0R, 44:895-46:940). The latter claim was made solely by Staff and not raised by any other party.

III. CONTESTED ISSUES

Notwithstanding Nicor Gas being the low-cost provider of natural gas among major Illinois gas utilities during the operation of the GCPP, the AG and CUB propose a host of adjustments to Nicor Gas' reconciliation filings, each of which seeks a refund to customers in varying amounts. Taken together, these refund requests, including interest, are approximately \$305 million (CUB) and \$255 million (the AG). CUB Ex. 2.01; AG Ex. 1.3 Rev., Sch. DJE-7. The Stipulation between Nicor Gas and Staff effectively moots most of the issues that CUB raised and one of two issues that the AG raised. That is because—as demonstrated in the chart below—the dollar values of the total refund to be paid by Nicor Gas were allocated by Staff in identical, or nearly so, amounts to the refunds sought by CUB and the AG on the same issues. *See, e.g.*, Nicor Cross Ex. 1.0. Indeed, CUB witness Mierzwa conceded at the evidentiary hearings that this is the case as to the claims he advances. *Id.*; Tr. 1109:15-21.

Comparison of CUB and AG Positions to Staff/Nicor Gas Stipulation

<u>Adjustment</u>		<u>CUB Proposal¹⁵</u>	<u>AG Proposal¹⁶</u>	<u>Staff Allocation Per Stipulation¹⁷</u>
LIFO Benefit		\$24,018,412	\$25,156,000	\$21,871,934
Storage Carrying Charges		\$40,974,944	N/A	N/A ¹⁸
DSS Withdrawals		\$8,149,519	N/A	W/D ¹⁹
In-Field Storage Transfers		\$11,149,901	N/A	\$11,149,901
2001 Storage Withdrawals		\$155,320,932	\$181,879,000	N/A
TGP & MGT Capacity Costs		\$1,495,217	N/A	\$1,475,267
Capacity Mgmt. Credits – 1999		\$3,216,169	N/A	\$3,216,169
Capacity Mgmt. Credits – GCPP		\$5,893,472	N/A	\$5,893,472
Affiliate Below Market Sale		\$4,258,605	N/A	\$4,258,586
Aquila Weather Insurance		\$2,100,000	N/A	\$2,057,525
Hub Revenues		\$0	N/A	\$6,150,917
Total Adjustment		\$256,577,170	\$207,035,000	\$56,073,771
Less: 2001 Cycling & Storage Carrying Charge Adjustments		<\$196,295,876>	<\$181,879,000>	\$0
Total		\$60,281,294	\$25,156,000	\$56,073,771
Difference as compared to Stipulation with Staff		\$4,207,523	-\$30,917,771	

Accordingly, the Commission is ultimately left with four contested issues: (1) the AG’s and CUB’s claims concerning Nicor Gas’ 2001 storage cycling; (2) CUB’s claim concerning alleged storage carrying charges; (3) CUB’s claim regarding DSS storage withdrawals; and (4) RESA’s claim concerning how any refund should be allocated. As discussed more fully

¹⁵ Dollar amounts as set forth in Cub Exhibit 2.01 Revised.

¹⁶ Dollar amounts as set forth in AG Exhibit 1.3 Rev., Sch. DJE-7.

¹⁷ This column references Staff’s allocation as set forth in paragraph 3 of Nicor/Staff Exhibit 1.0.

¹⁸ “N/A” means that Staff or the AG never proposed or supported this adjustment.

¹⁹ “W/D” means that Staff withdrew this proposed adjustment per paragraph 4 of Nicor/Staff Exhibit 1.0.

below, the three adjustments among these claims should be rejected for numerous reasons.²⁰

Although they are essentially rendered moot by the Stipulation between Nicor Gas and Staff, Nicor Gas briefly addresses the remaining adjustments proposed by the AG and CUB. As set forth below, Nicor Gas has submitted substantial and compelling evidence demonstrating that these proposed adjustments are contrary to applicable law, the facts, or both.

A. LIFO Benefit

The AG and CUB argue (as did Staff) that Nicor Gas' customers should obtain 100% of the benefit of low-cost LIFO layers of gas inventory withdrawn during the Company's operation of the GCPP because the Company did not identify such withdrawals to the Commission as an alleged "strategy" for beating the Benchmark. Effron Dir., AG Ex. 1.2 Rev., 35:9-18; Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 22:562-23:590, 33:916-929. The value of the benefit is estimated by the AG at \$25,156,000, and CUB at \$24,018,412. AG Ex. 1.3 Rev., Sch. DJE-7; CUB Ex. 1.09. The Stipulation between Nicor Gas and Staff fully addresses this issue—Nicor Gas will refund \$21,871,934, which is the amount claimed by Staff to represent 100% of the LIFO benefit. Therefore, it is Nicor Gas' position that this issue is moot.

B. Storage Carrying Charges

In a clear contradiction to his argument discussed below that the low-cost LIFO layers would have been accessed under traditional regulation, CUB witness Mierzwa argues that Nicor Gas' customers should be refunded the higher storage inventory carrying costs from allegedly replacing low-cost LIFO layers with high-cost LIFO layers. Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 34:946-63. Neither Staff nor the AG supports this claim; thus, Mr. Mierzwa is alone in proposing this adjustment in an amount of \$40,974,944. CUB Ex. 2.02. The Commission

²⁰ Nicor Gas does not oppose Staff's proposed mechanism to refund the \$64 million set forth in the Stipulation. However, it reserves the right to respond to any refund allocation proposals made by other parties in briefs.

should reject this adjustment because of the lack of legal or factual support for the position that low-cost layers should never be accessed, which is the logical conclusion of Mr. Mierzwa's claim. Specifically, Mr. Mierzwa's claim for storage inventory carrying costs implies that low-cost gas in storage should never be accessed because, by definition, it would always need to be replaced by higher-cost gas. *Carpenter Reb., Nicor Gas Ex.* 5.0R, 9:167-70. Thus, CUB's position is factually flawed.

CUB's position also is legally flawed. Importantly, nothing in the Act or the Commission's Rules prohibits a utility from using gas in inventory. Staff witness Zuraski agreed to this point. Tr. 1284:12-15. Further, nothing in the Act or the Commission's Rules prohibits a utility from adding a LIFO layer of gas that is priced higher than a previous layer of gas. Staff witness Zuraski also agreed to this point. Tr. 1284:7-11. In addition, nothing in the Act or the Commission's Rules even suggests that a utility should be penalized when it adds a LIFO layer of gas that is priced higher than prior layers.

CUB's proposed adjustment on this point would require the Commission to engage in single-issue ratemaking and adjust rates that it previously found just and reasonable in Nicor Gas rate cases decided after 2003. For example, in Nicor Gas' 2004 rate case, the Commission found Nicor Gas' valuation of gas in storage to be just and reasonable, which included the 2003 LIFO layer of gas now targeted by CUB. Docket No. 04-0779, Order at 19 (Sept. 20, 2005).²¹ *See also* Docket No. 08-0363, Order (Mar. 25, 2009 and Oct. 7, 2009). Thus, CUB's proposal would constitute improper single-issue and retroactive ratemaking. *See, e.g., Citizens Util. Bd. v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 136-37 (1995) ("The rule against single-issue

²¹ In Nicor Gas' 2004 rate case, the Commission deferred decision on whether the use of the LIFO layers during the GCPP was appropriate, and that issue has now been resolved in the Stipulation.

ratemaking ... prohibits the Commission from considering changes to components of the revenue requirement in isolation. Consideration of any one item in the revenue formula in isolation risks understatement or overstatement of the revenue requirement.”) (citations omitted); *Citizens Utilities Co. v. Illinois Commerce Comm’n*, 124 Ill. 2d 195, 210-11 (1988) (“Allowing the rate base reduction to stand would sanction retroactive ratemaking, a practice that this court has long condemned as inconsistent with the statutory scheme and the Commission’s role in the ratemaking process.”).

Moreover, CUB’s adjustment is completely inconsistent with the Commission’s acceptance of the LIFO methodology of accounting for gas in storage. For example, the Commission’s uniform system of accounts for gas utilities permits withdrawals of gas to “be priced according to the first-in-first-out, last-in-first-out, or weighted average cost method” and requires approval of the Commission “for any other pricing method, or change in the pricing method adopted by the utility.” 83 Ill. Adm. Code 505.1170(C). In authorizing this practice, the Commission recognized that additional layers necessarily would be added to storage inventory with different prices.

Finally, Mr. Mierzwa attempts to impose a prudence standard on Nicor Gas’ decision to access the low-cost LIFO standards, which is legally improper in a performance-based regulation context. *See, e.g.*, Docket No. 99-0127, Order at 37 (Nov. 23, 1999) (citing Section 9-244 of the Act). Even if prudence was an appropriate standard in this case, Mr. Mierzwa fails to support his claim that Nicor Gas acted imprudently in accessing the low-cost inventory. *Carpenter Reb.*, Nicor Gas Ex. 5.0R, 26:492-27:507.

C. DSS Withdrawals

Staff witness Zuraski originally asserted, and CUB witness Mierzwa followed, the argument that Nicor Gas incorrectly quantified storage withdrawals associated with its leased

storage capacity (particularly, its delivered storage service or “DSS” storage capacity) on Natural Gas Pipeline Company of America, a portion of which the Company released to third parties during 2000-2002. Zuraski Dir., Staff Ex. 1.0R, 36:743-38:795; Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 39:1087-41:1151. Staff subsequently withdrew its claim on this issue as part of the Stipulation with Nicor Gas. Nicor/Staff Ex. 1.0.

According to Mr. Mierzwa, the required correction due to these “unaccounted for” withdrawals impacts the Storage Credit Adjustment component of the GCPP Benchmark and results in an adjustment of \$8,149,519. CUB Ex. 1.12. Yet, Mr. Mierzwa’s claim flies in the face of the fact that Nicor Gas already has corrected the prior treatment of its December 1999 sale/release of DSS to IMD Storage Management and Asset Transportation Company in its restated GCPP results to account for its use of DSS (and NSS) storage between 2000 and 2002, and those restatements were accepted by Staff and Intervenors. Carpenter Reb., Nicor Gas Ex. 5.0R, 10:187-89, 35:671-72, 36:685-87. Indeed, Nicor Gas’ restated results were ratified by Nicor Gas’ outside independent auditors and were accepted by the SEC. Carpenter Sur., Nicor Gas Ex. 10.0, 24:459-61; *see also* Tr. 1231:6-20 (Mierzwa).

Mr. Mierzwa provides no evidence in support of his claims, but relies entirely on speculation that Nicor Gas and its outside independent auditors did not get the restatement right in allegedly missing some DSS storage withdrawals. Carpenter Reb., Nicor Gas Ex. 5.0R, 35:672-81; Carpenter Sur., Nicor Gas Ex. 10.0, 23:422-25:463. For example, Mr. Mierzwa relies on a discrepancy in the amount of DSS withdrawals between two Nicor Gas documents: one (NIC 114180) showing 7.2 million MMBtu DSS withdrawals more than the other (NIC 109409). *See, e.g.*, Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 40:1123-41:1151; CUB Ex. 1.12. Mr. Mierzwa uncritically (and for reasons unexplained) selects the higher figure even though

Nicor Gas and its auditors obviously rejected reliance on that document. The figures shown in NIC 109409 (Nicor Gas Ex. 10.2), which was used for the restatement, represent Nicor Gas' actual physical DSS withdrawals. Furthermore, Nicor Gas' contemporaneous Aquifer Reports, which are excerpted in Nicor Gas Exhibit 10.3 and were provided to CUB in discovery, show DSS withdrawals that confirm those shown on NIC 109409. Finally, the figures shown in NIC 109409 also correspond to the DSS withdrawals shown on other Nicor Gas documents relating to DSS injections and withdrawals in the relevant timeframe. These documents—NIC 114182 and NIC 114183—were also provided to CUB in discovery and are in the record at Nicor Gas Exhibit 10.4. Given this evidence, Nicor Gas witness Dr. Carpenter testified that Mr. Mierzwa did not justify his claim that the difference he identified between two documents should be used to adjust Nicor Gas' restated results. Carpenter Sur., Nicor Gas Ex. 10.0, 24:447-57. In light of the contrary evidence submitted by Nicor Gas, CUB's unsubstantiated adjustment relating to DSS withdrawals should be rejected.

D. In-Field Storage Transfers

Staff originally proposed that all withdrawals related to so-called "in-field transfers" be included in calculating the Benchmark during the GCPP period. Zuraski Dir., Staff Ex. 1.0R, 34:694-35:722. CUB witness Mierzwa merely repeats Staff's claim. Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 45:1242-46:1268. CUB quantifies the proposed adjustment related to this issue at \$11,149,901. CUB Ex. 1.13. The Stipulation between Nicor Gas and Staff fully addresses this issue and reflects a refund of \$11,149,901—the exact amount CUB seeks on this issue. Therefore, it is Nicor Gas' position that this issue is moot.

E. 2001 Storage Withdrawals

Although utterly lacking in clarity, and indeed shifting in theory during the course of this proceeding, the primary claims raised by the AG and CUB stem from their shared position that

Nicor Gas' customers are due a substantial refund for gas costs incurred in 2001. Their claims are apparently based upon the belief of the AG and CUB that Nicor Gas improperly withdrew too much gas from storage inventory in 2000. *See, e.g.*, Tr. 1201:19-1202:5 (Mierzwa). That, in turn, forced Nicor Gas to rely on purchases of expensive market gas in 2001 instead of withdrawals of gas from storage inventory. *See, e.g.*, Mierzwa Reb., CUB Ex. 2.0 Rev., 27:621-45:1007; Effron Reb., AG Ex. 1.4 Rev., 1:18-18:371. At their maximum calculations, the AG's adjustment seeks \$181,879,000 and CUB's adjustment seeks \$155,320,932. Carpenter Reb., Nicor Gas Ex. 5.0R, 13:254-55, 13:268-69; Effron Dir., AG Ex. 1.2 Rev., 26:1-27:4; AG Ex. 1.3 Rev., Sch. DJE-7; Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 53:1450-58; CUB Ex. 2.01.²² Notably, Staff never joined the AG and CUB in making these claims.

Fundamentally, the storage withdrawal claims by the AG and CUB ignore the overwhelming evidence demonstrating that Nicor Gas' physical storage operations in 2000 and 2001 were dictated by market conditions and were completely consistent with national trends at the time. Specifically, inventory levels at the end of October were normal. November and December 2000 were months in which unusually cold weather was experienced in the Nicor Gas territory and nationwide. *See, e.g.*, Carpenter Reb., Nicor Gas Ex. 5.0R, 18:335-19:386. These "frigid temperatures caused a surge in demand that led to soaring prices and a rapid drawdown of storage levels." *Id.* at 19:373-75. The drawdown of underground natural gas storage inventories impacted all gas utilities, not just Nicor Gas. Carpenter Sur., Nicor Gas Ex. 10.0, 13:234-37, Figure 4 at 14:245-46; Tr. 1224:14-20 (Mierzwa). Given the unusual weather conditions in late

²² Mr. Effron claims that had Nicor Gas, in 2001, withdrawn from storage the amounts of gas that it had withdrawn in 1998 or in 1994-1998 (on average), and thereby reduced its reliance on market purchases of gas, the cost of gas would have been decreased by \$144.8 million and \$181.9 million, respectively. Effron Dir., AG Ex. 1.2 Rev., 5:7-10, 25:10-26:19, 32:12-19; AG Ex. 1.3 Rev., Sch. DJE-5. Mr. Mierzwa's similar calculation uses 1996 as the base year for comparison.

2000 and the unforeseeable and unprecedented spike in natural gas prices, Nicor Gas reasonably relied on gas in storage to serve its customers during that period. *See, e.g.,* Carpenter Reb., Nicor Gas Ex. 5.0R, 19:387-21:406; Moes/Gulick Sur., Nicor Gas Ex. 12.0R, 11:233-17:309. The resulting depletion of Nicor Gas' inventory that caused Nicor Gas to rely on market purchases in 2001 was not the result of any improper decision on the part of Nicor Gas.

More specifically, the AG's and CUB's claims lack merit for at least the following reasons. First, they are not based on any coherent regulatory theory that could trigger refunds in this case. Second, these claims rest on an unduly narrow, snapshot in time view of customer impact under the GCPP. Third, and perhaps most important, neither Mr. Mierzwa, a financial analyst, nor Mr. Effron, a certified public accountant, has any experience or expertise in the highly complicated business of managing or operating gas storage facilities, an operation in which a simple miscalculation can have catastrophic financial and physical consequences for the utility and its customers. Consequently, neither supports his claim with any experience or evidence, but instead on assumed or inferred "facts" that have no basis in the record. Fourth, as just demonstrated, the assumptions underlying these claims are contradicted by more plausible, real world explanations for what actually transpired.

In sum, the purchases of which AG and CUB complain were necessitated by unusually severe weather and market conditions in late 2000 that affected not only Nicor Gas, but all gas utilities nationwide. Contrary to the positions espoused by AG and CUB, Nicor Gas' activities in 2000 and 2001 were not motivated by a desire to benefit under the GCPP, but instead were dictated by market conditions over which Nicor Gas had no control.

1. CUB and the AG Lack a Coherent Theory of Liability

It is not clear what legal or regulatory theory underlies these claims. Whatever they are, they fly in the strong headwind of the fact that in 2001, gas costs to Nicor Gas' customers were

lower than those for virtually every other gas utility in Illinois, showing that Nicor Gas managed market conditions, which affected all utilities, better than others did. In fact, Nicor Gas' performance vis-à-vis other gas utilities was better *during the GCPP* period than it was in the two years before the GCPP period. *See, e.g.,* Gorenz Reb., Nicor Gas Ex. 3.0, 15:302-11 and Nicor Gas Ex. 3.1. This fact, by itself, is strong evidence that Nicor Gas did nothing with an intent to or that had the effect of harming customers.

Mr. Effron testified that he is not claiming that Nicor Gas acted “imprudently.” In particular, he is not arguing that Nicor Gas acted imprudently in purchasing the quantities of gas it did in 2001. Tr. 1330:11-16. Nor is he taking the position that Nicor Gas paid more than market price for the gas it bought in 2001, or that the price was unreasonable in some other way. Tr. 1330:17-1331:2. Finally, it is not his position that Nicor Gas acted imprudently in allowing its inventory levels to reach the levels they did by the end of 2000. Tr. 1342:19-1343:5. Indeed, Mr. Effron testified that: “In my testimony I am not accusing Nicor [Gas] of having acted imprudently or having manipulated anything or any wrongdoing.” *Id.*

Mr. Mierzwa's theories are no less obscure, but much more convoluted and confusing. Initially Mr. Mierzwa claimed that the decision Nicor Gas made in “early 2001” to reduce gas withdrawals in 2001 was due to a concern about Nicor Gas' performance under the GCPP. Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 52:1426-28. Even were that the case, Mr. Mierzwa does not appear to argue that it was improper for Nicor Gas to be “concerned” about its performance under the GCPP, nor does it appear that any such claim would be facially plausible—a utility under performance-based regulation should be concerned about its performance, especially when customers will share in gains and losses. In any event, Mr. Mierzwa has no factual basis for his claim as to what motivated Nicor Gas to reduce 2001 withdrawals. He simply “believes” that the

low NGPL inventory levels that led to lower 2001 withdrawals and greater 2001 gas purchases was the result of efforts to access low-cost LIFO gas. Mierzwa Reb., CUB Ex. 2.0 Rev., 39:866-67. He has no evidentiary basis for this other than his “belief.” Tr. 1202:6-16; Tr. 1204:7-19. Although he purports to rely on CUB Ex. 1.16 to support this conclusion, that document does not refer to “the effect on the benchmark” as a reason affecting 2001 withdrawals.

By the time of his rebuttal testimony two years later, Mr. Mierzwa’s theory had evolved into one closer to that espoused by Mr. Effron, based largely on allegedly “imprudent” management of inventory levels; it was because of Nicor Gas’ “imprudent management” of gas inventories in 2000 that withdrawals were lowered in 2001.²³ “Because of low storage inventory levels which existed just prior to January 2001, Nicor [Gas] established its 2001 withdrawal cycle at 60 Bcf.” Mierzwa Reb., CUB Ex. 2.0 Rev., 44:988-89; *see also* Tr. 1113:13-22; Tr. 1125:11-1126:8. After the initial withdrawal level was established, Mr. Mierzwa then faults Nicor Gas for following the monthly inventory withdrawal percentages established by the Commission’s Order approving the GCPP, claiming it was “imprudent” for Nicor Gas to have done so. Tr. 1134:7-1135:5; Tr. 1147:11-22. At the same time, Mr. Mierzwa conceded that deviating from the specified percentages could have exposed both Nicor Gas and its customers to financial risk under the GCPP. Tr. 1176:21-1177:6. Mr. Mierzwa concedes that he has never claimed that Nicor Gas paid more than market price for the gas it purchased at any time during the GCPP. Tr. 1112:10-1113:12.

²³ He makes his claims of “imprudence” even though he has no experience managing gas storage inventories, and although he concedes that such management is a complicated operation that if badly mismanaged can have catastrophic effects on the utility and its customers. Tr. 1114:8-22. And, of course, any prudency review reasonably must take into account the operational aspects of system integrity and safety and should not be limited solely to the type of financial review performed by Mr. Mierzwa, as well as Mr. Effron.

Significantly, Mr. Mierzwa does not point to any contemporaneous facts or information available to Nicor Gas that would or might have caused a reasonably prudent gas inventory manager to conduct operations in 2000 or 2001 differently from the way Nicor Gas did. Indeed, he cannot say when in 2001 it became imprudent for Nicor Gas to continue to adhere to those percentages. Tr. 1148:15-18. Instead, Mr. Mierzwa bases his assertion of imprudence, including those based on Nicor Gas following the Commission's established withdrawal percentages, on the *outcome*—that doing so increased costs to ratepayers—even though Mr. Mierzwa also accepts (as he must) the well-established proposition that “simply because an action has a certain result does not make it imprudent.” Tr. 1137:11-22.

Furthermore, although Mr. Mierzwa initially claimed that Nicor Gas' reduction of the withdrawal cycle in early 2001 *to match* the percentages set forth in the Commission's Order approving the GCPP was imprudent, he then claims that Nicor Gas' *deviation from* the withdrawal percentages in September 2001, was likewise imprudent because this deviation increased costs to customers. Tr. 1162:14-1163:4.²⁴ Here, of course, Mr. Mierzwa faces another inconsistency in his position: significant deviations from historical practice can lead to a finding of “manipulation,” but adherence to historical patterns (the withdrawal percentages) can be “imprudent” if the result is unfavorable. Aside from that dramatic inconsistency, however, Mr. Mierzwa does not and cannot show that any deviation from historical percentages in and after September 2001 harmed customers. To the contrary, Mr. Mierzwa's own exhibit (CUB

²⁴ Mr. Mierzwa relies on CUB Ex. 1.14 to support his claim concerning the motivation for the September 2001 “decision.” Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 51:1403-4, citing CUB Ex. 1.14. This document does not discuss the impact of a reduced withdrawal cycle on either the benchmark or, more broadly, the GCPP, nor does it reflect any decision at all to reduce the withdrawal cycle. Notably, each of the key personnel listed on both CUB Exhibits 1.14 and 1.16 was deposed by CUB and the AG but neither party asked a single question about the documents or the substance addressed therein even though Mr. Mierzwa personally developed questions for the depositions. Tr. 1180:14-22.

Ex. 1.18) shows that if Nicor Gas had not decreased withdrawals in and after September 2001—as he claims it should not have done—customers would have incurred *increased* gas costs in the amount of about \$9 million through the rest of 2001. Tr. 1188:2-18.

More fundamentally, it bears repeating that Mr. Mierzwa does not present any evidence that suggests that Nicor Gas had available to it any facts that should have put it on notice that its adherence to the historical monthly withdrawal percentages reflected in the Commission Order, or its September 2001 “deviation,”²⁵ would likely have an adverse outcome that could have been avoided by pursuing a different course of action. In the absence of such evidence it cannot be concluded that Nicor Gas acted imprudently, even if imprudence were a relevant standard in this case.

Imprudence, however, is not the standard by which Nicor Gas’ actions during the GCPP period are to be judged. The Commission’s Order in Docket No. 99-0127, approving the GCPP, expressly rejected holding “prudence reviews” even if losses exceeded a threshold level. “Instead of the *traditional prudence review*, Section 9-244(c) requires that the Commission review the program two years after its implementation to determine whether it is meeting its objective.” Order, Docket No. 99-0127, at 37 (Nov. 23, 1999) (emphasis added). That Order has never been modified, nor is the continuing validity of that Order in question here. In the Second Interim Order in Docket No. 02-0067, which frames the issues for this case, the Commission reopened the record in Docket No. 02-0067 and consolidated all three dockets (01-01-0705 and 02-0725) “to consider for final resolution . . . all issues relating to *the operation* of the Program Nicor Gas implemented under tariffs filed in accordance with the Commission’s

²⁵ In fact, the “evidence” he cites with respect to the September 2001 decision is a memorandum that reflects on its face that lowering the 2001 withdrawal cycle “may be in the best interest of Nicor Gas *and its customers*” and that “Nicor [Gas] *and its customers* will save money.” CUB Ex. 1.14 Rev. (emphasis added).

Order entered November 23, 1999, in Docket 99-0127, and all issues relating to any refunds that may be owing to Nicor [Gas] customers as a result of *the operation* of the Program....” Docket No. 02-0067, Second Interim Order at 6 (Dec. 17, 2002) (emphasis added). No issues concerning *the approval or modification* of the GCPP are involved here.

No doubt recognizing that his claims of imprudence are doomed from the start, Mr. Mierzwa also asserts that Nicor Gas attempted to “manipulate” its storage facilities and this led to excessive gas costs. Tr. 1118:8-14. By “manipulate,” Mr. Mierzwa means that a party took actions that produced results “significantly” different from historical results with the intent by the party to benefit itself. Tr. 1119:11-17; Tr. 1121:9-11. Here the “two-part” test is satisfied, according to Mr. Mierzwa, by evidence that 2001 storage withdrawals were reduced to approximately one-half of historic levels because the 2000 inventory levels had been reduced substantially so that Nicor Gas could benefit itself by accessing low-cost LIFO gas. Tr. 1120:22-1121:7. It is not necessary that the acting party, here Nicor Gas, has an intent to harm another party or group, *e.g.*, ratepayers, and further, Mr. Mierzwa concedes he has seen nothing to suggest that any efforts to reduce 2000 inventory levels were intended or even thought to be harmful to customers. Tr. 1124:1-9.

Despite his definition of “manipulation,” Mr. Mierzwa inconsistently testified that a situation in which a company does something different from the way it has done in the past with the intent to benefit itself, but without any intent to harm another party, would not be “manipulation.” Tr. 1123:12-21. But, at most, that apparently is what happened here—and what happens countless times every day in every business and industry in the country, including the utility industry—and so even under his own definition Mr. Mierzwa appears to concede that no manipulation occurred. Tr. 1124:10-1125:2. In any event, neither Mr. Mierzwa nor CUB has

ever brought to the Commission's attention any case in which the Commission has adopted this as a standard by which it could order refunds in the tens of millions of dollars or more. Nor, for obvious reasons, is it a standard the Commission should or even can use to justify the draconian relief sought here. Moreover, though it is not a finding that is binding on the Commission, it is worthwhile to note that the investigative team of attorneys and accountants led by Scott Lassar, the former United States Attorney for the Northern District of Illinois, specifically found that the lower level of withdrawals in 2001 was not because of "improper attempts to manipulate the storage cycle." CUB Ex. 1.02 Rev. at 52, n.24.

2. The AG and CUB Claims Take an Impermissibly Narrow View of Customer Impacts

Aside from their theoretical flaws, both the Effron and Mierzwa analyses focus on only one year of the three-year GCPP period. Each analysis fails to consider what gas costs were or might have been in the *other two years* of the program, even though Mr. Mierzwa agrees that altering withdrawals and injections in one year can have effects outside that year. Tr. 1192:15-1193:2. When asked whether a similar analysis including those years might show net savings to customers, he answered that he did not know. Tr. 1193:7-11. Mr. Effron agrees that his analysis focuses solely on 2001, and does not, for example, present the impact on customers in 2000 had Nicor Gas bought more gas in that year to avoid the low year-end 2000 inventory levels that led to greater purchases in 2001, though he concedes an impact would have resulted. Tr. 1341:14-1342:10. Once again, it would not be proper for the Commission to award relief based on one year's analysis of effect on customers (even if the analysis had any basis) without considering the other two years of the GCPP.

3. The AG and CUB Claims are Based on Assumptions, Not Evidence

Although his “loss to customers” analysis is based on how customers would have fared had inventory withdrawals supplanted market purchases of gas in 2001, Mr. Effron does not contend that these greater withdrawals were possible. Mr. Effron concedes that he does not claim that Nicor Gas could have implemented the increased levels of 2001 withdrawals reflected in his calculations given the relatively low level of inventory at the end of 2000, and is “not arguing that it would have been practical, or even possible, to increase the 2001 withdrawals to the 1994-1998 five year average or to the 1998 level of withdrawals, given the storage inventory of 72.1 Bcf at the end of 2000.” Effron Reb., AG Ex. 1.4 Rev., 8:174-9:176; 9:187-89; Nicor Cross Ex. 7.²⁶

This concession is important. The relatively low level of gas inventory at the end of 2000 was a fact, and it is true that this low inventory level made it impossible for Nicor Gas to withdraw in 2001 what it did in prior years. But the reason(s) for this low level of inventory at year-end 2000 are very much disputed. Without a shred of evidence to back it up, Mr. Effron and Mr. Mierzwa claim that it was the result of Nicor Gas’ attempt to rid itself of high-cost

²⁶ Mr. Effron identified two other factors that could have led to the reduced 2001 withdrawals: (1) a “probable developing realization” that the Storage Credit Rate for 2001 would be “higher than normal” and therefore that minimizing withdrawals would increase the Benchmark; and (2) given that January withdrawals appear to have been related to the volume of January deliveries, reduced deliveries in January because of warmer than normal weather could have led to reduced withdrawals. Effron Dir., AG Ex. 1.2 Rev., 28:7-15. Neither, however, can be considered a reason, because Mr. Effron has already conceded Nicor Gas was in no position to have increased withdrawals in 2001. *See* Tr. 1331:4-16 (“that is probably true with regard to January, but not to the following months”). Indeed, later in his testimony, Mr. Effron explicitly rejects the explanation that the lower January 2001 deliveries somehow accounted for the lower January 2001 withdrawals, by pointing out that January 1998 and January 2001 deliveries were similar, but January 1998 withdrawals were substantially higher than in January 2001. Effron Dir., AG Ex. 1.2 Rev., 30:1-31:6. During cross examination, Mr. Effron “clarified” this point by noting that he eliminated weather as a factor but only in his comparison to 1998, not his comparison to 1994-98. Tr. 1312:9-1313:3. This makes no sense. If January 2001 weather was not a factor that affected January 2001 withdrawals in one case, how can it then be said to have been a factor affecting withdrawals when making another comparison. Weather was either a factor in January 2001 or it was not.

inventory layers so that it could access the low-cost layers of gas in inventory and thereby achieve savings in gas cost and beat the Benchmark to its (and its customers') advantage.

As a preliminary matter, it is not apparent what conclusion should or would be drawn from a factual finding that Nicor Gas' withdrawals in 2000 were motivated by efforts to access low-cost LIFO inventory, a finding which in any event cannot be made on this record. The benefits (or adverse effects) of this access would have been shared equally by Nicor Gas and its customers. So long as these withdrawals were not effectuated in the face of knowledge that their ultimate impact would have been beneficial to Nicor Gas but harmful to customers—and not a scintilla of evidence to support this can be found in the record—withdrawals for this purpose cannot plausibly be the basis for any type of regulatory response.

In any event, neither Mr. Effron nor Mr. Mierzwa cites a single document or other piece of evidence that tends to support the conclusion that the late 2000 inventory withdrawals were motivated by attempts to access low-cost LIFO. Mr. Mierzwa concedes that he did not find a single document that reflects an "intent" on the part of Nicor Gas to lower 2000 inventory levels to benefit itself. Tr. 1121:12-16; Tr. 1122:17-21. Notably, the only documentary evidence that does exist directly contradicts this conclusion. CUB Exhibit 1.05 Revised states, at page 2, that as of August 4, 2000, although Nicor Gas thought it might have the ability to effect a year-end inventory reduction, "there is no expectation that it will actually happen." Mr. Effron does not contest that. Tr. 1336:15-1337:9. Nor does he recall whether he analyzed how circumstances may have changed after August 4, 2000, and may have influenced withdrawals for the rest of 2000. Tr. 1337:10-14. In any event, he has not presented the results of any such analysis.

As will be discussed more completely in the following section, the evidence shows that the low level of inventory at the end of the year 2000 was due primarily to a combination of

weather and increasing prices in November and December 2000 that led Nicor Gas, and many other gas utilities, to rely more heavily on inventory withdrawals than on market purchases. Mr. Effron is not aware of any facts that contradict—and he does not contest—the testimony he has seen that Nicor Gas’ low inventory levels at the end of 2000 “were consistent with low inventory levels at gas utilities nationwide.” Tr. 1337:15-1338:2.

Notably, inventory levels at the end of *October 2000* were similar to what they had been historically, indicating that for at least the first ten months of 2000, Nicor Gas had not been engaging in withdrawals intended to affect the Benchmark. Carpenter Sur., Nicor Gas Ex. 10.0, 7:139-48. Mr. Effron did not analyze end of October 2000 inventory levels or how they compared to October inventory levels in other years, and thus has no basis on which to disagree with the conclusion that end of October levels were normal. Tr. 1334:22-1335:13. Furthermore, because Mr. Effron concedes there was nothing unusual about the level of withdrawals in December 2000 (Effron Reb., AG Ex. 1.4 Rev., 7:146-51), the focus should be on what happened in *November 2000*. The facts relating to this month will be discussed in the following section and will show that the Effron and Mierzwa speculations are groundless.

By the time of his rebuttal testimony Mr. Effron modified his position slightly and claimed that although low 2000 inventory levels were the major factor explaining low withdrawals in *January 2001*, other factors explained the low level of withdrawals throughout the remainder of 2001. Effron Reb., AG Ex. 1.4 Rev., 5:106-08, 14:278-18:362; Tr. 1310:14-1311:5.

Mr. Effron claims that although January 2001 withdrawals were limited by year-end 2000 inventory levels, the situation after January should be looked at a little differently because inventory at the end of January “wasn’t *extraordinarily low* at the end of January like it was at

the beginning of January.” Tr. 1332:16-17 (emphasis added). He further concludes that had Nicor Gas withdrawn more gas in February through December 2001, Nicor Gas’ customers would have been better off. Effron Reb., AG Ex. 1.4 Rev., 17:339-18:362; Tr. 1351:19-1352:22. He does not present in his testimony, however, any information that suggests that by relying on gas purchases in the last eleven months of 2001, Nicor Gas acted in disregard of its customers’ interests or improperly in any way. Again, his basic complaint is that Nicor Gas followed the withdrawal percentages set forth in the Commission’s Order approving the GCPP, although he does not claim this was “imprudent” as Mr. Mierzwa does.

But Mr. Effron’s principal premise—that inventory levels had sufficiently recovered by the end of January 2001 to allow greater withdrawals—is not only inconsistent with his initial position that Nicor Gas could not have withdrawn gas throughout 2001 that matched the withdrawals in either of his comparison periods, but further it is unsubstantiated and contradicted by the actual facts. For example, Mr. Effron has estimated that in February and March 2001, Nicor Gas could have withdrawn another 24.5 Bcf of gas from inventory rather than rely on market purchases, as sufficient inventory existed to allow Nicor Gas to do that. Tr. 1355:14-1356:16. He asserts that inventory levels at the end of January 2001 were “lower than average but not unreasonably low and that would have allowed for greater withdrawals going forward.” Tr. 1358:13-17.

The inventory level at the end of January 2001 was 56.8 Bcf. By way of comparison, the evidence reflects that at the end of January 2000 the level was 65.5 Bcf, 1999 was 76.2 Bcf, 1998 was 81.8 Bcf and 1997 was 73.3 Bcf. Tr. 1360:16-1361:17. On average, then, the inventory levels at the end of January for the four years preceding 2001 were 72.4 Bcf – or 17.4 Bcf (more than 30%) higher than in 2001. And although Mr. Effron agrees that a number of factors other

than inventory levels affect the ability to rely on storage withdrawals (Tr. 1358:18-1359:4), his analysis does not address any of those other factors. Clearly, Mr. Effron's premise that Nicor Gas "could have" withdrawn more gas after January 2001 rests on no foundation at all.

4. The Low Year End 2000 Inventory Levels Were Part of a Nationwide Pattern, and in Nicor Gas' Case can be Explained by Factors Unrelated to the GCPP

A variety of evidence shows the low level of physical inventory levels at year-end 2000 was not caused by any efforts by Nicor Gas to access low-cost LIFO and obtain benefits under the Benchmark. First, the evidence shows it was not necessary that Nicor Gas increase physical withdrawals in order to access the low-cost inventory. The Lassar Report, for example, noted that Nicor Gas attempted to access its low-cost LIFO layers not through physical withdrawals, but rather through accounting strategies such as "storage prefills." *See* CUB Ex. 1.02 Rev. at 57-64. As the Lassar Report recognized, these transactions had two essential characteristics: (1) gas would actually be stored on Nicor Gas' system but (2) would not be recognized as a Nicor Gas injection and would not constitute a new high-cost "layer" that would obstruct access to the low-cost layers. *Id.* at 59. The Report concluded that "Storage prefills were the foundation of Nicor [Gas'] PBR strategy, and changing the accounting treatment of these prefills has a dramatic effect on Nicor [Gas'] performance under the PBR. In effect, without the benefit of Nicor [Gas'] assumed accounting treatment of prefill transactions, Nicor [Gas] cannot access the low-cost LIFO layers it recognized on its financial statements." *Id.* at 63.

Testimony in this case makes that same point. Staff witness Zuraski testified that "pre-fill storage deals" were the means chosen by Nicor Gas to access low-cost LIFO inventory. Zuraski Dir., Staff Ex. 1.0R, 12:235-45. Mr. Zuraski explained that "pre-fill deals allowed Nicor [Gas] to maintain normal physical storage operations while still showing extraordinary net withdrawals, due to the manner in which the Company accounted for the deals." *Id.* at 12:242-

44. Similarly, Nicor Gas witnesses David Moes and Christopher Gulick concluded that it was not necessary for the Company to physically drawdown the storage inventory in order to access the lower cost LIFO layers. Moes/Gulick Sur., Nicor Gas Ex. 12.0R, 18:314-15. Mr. Mierzwa likewise concedes that it was not necessary for Nicor Gas to use physical withdrawals to access LIFO inventory, that storage prefills were the means by which that was accomplished. Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 36:1020-21. Mr. Efron also testified that “the intent of the storage prefills was to allow Nicor [Gas] to maintain the physical inventory quantities necessitated by operational requirements while also preserving access to the lower priced layers of inventory.” Efron Dir., AG Ex. 1.2 Rev., 14:4-6. Thus, the testimony is unanimous that physical withdrawals were not necessary for Nicor Gas to access LIFO inventory.

Of course the availability of prefills would not necessarily *preclude* the use of physical withdrawals as another means to access low-cost LIFO, but in the absence of any evidence that Nicor Gas in fact used the physical withdrawal method to do so, and in light of the evidence that Nicor Gas had no incentive or need to do so, it would be unreasonable for the Commission to find that Nicor Gas nonetheless risked its important inventory levels and the security of supply to its customers to achieve an objective it could, and did, achieve by other means. The overwhelming evidence shows that the hypothesis that Nicor Gas’ year 2000 withdrawals were motivated by efforts to access low-cost LIFO inventory is not consistent with its actual strategy to access those layers through the accounting treatment of storage prefills. *See, e.g.*, Carpenter Sur., Nicor Gas Ex. 10.0, 9:177-80.

Nicor Gas witness Paul Carpenter, a principal at the Brattle Group, attributed the low level of physical inventory at the end of 2000 to extremely cold weather in November and December 2000. Carpenter Reb., Nicor Gas Ex. 5.0R, 18:329-21:406. Indeed, as mentioned

earlier, the evidence shows that in August 2000, Nicor Gas was anticipating that it would not need to withdraw much gas from inventory throughout the remainder of 2000 (CUB Ex. 1.05 Rev., p. 2), which is itself inconsistent with the hypothesis that year 2000 withdrawals were being used to access low-cost LIFO. Mr. Effron attempted to downplay the effects of weather on November withdrawals, arguing that weather that month was not unusually cold, but in the median of the 1994-2002 period, while withdrawals in November 2000 were the highest in that same nine-year period. Effron Reb., AG Ex. 1.4 Rev., 6:125-7:140. On the other hand, while the weather in December 2000 was much colder than normal, the withdrawals in December 2000 were not unusually high. *Id.* at 7:141-8:157. Thus, according to Mr. Effron, the colder than normal weather in November and December 2000 does not explain the low storage inventory at the end of 2000. *Id.* at 8:157-59.

The surrebuttal testimony of Nicor Gas witnesses Moes and Gulick refutes Mr. Effron's superficial conclusions on the impacts of weather in late 2000 by presenting a detailed analysis of the *distribution* of heating degree days within a particular period as opposed to the *total* number of degree days within the period, which is Mr. Effron's focus. For reasons explained by Messrs. Moes and Gulick, withdrawals are much more a function of the distribution of degree days, not total degree days. Moes/Gulick Sur., Nicor Gas Ex. 12.0R, 11:233-12:248.

Mr. Effron's comparison of total November degree days does not provide enough *detail* to understand storage utilization, and results in an underestimation of storage usage during colder periods and an overestimation during warmer periods. *Id.* at 16:294-97. When viewed from a proper perspective, the weather in November 2000 was unusually cold. *Id.* at 12:249-16:298. The weather pattern that prevailed in November 2000 was the type that "leads to an increased usage of storage and increased withdrawals." *Id.* at 16:293-94. A balanced view of all the

available information leads to a reasonable conclusion that the much colder temperature patterns strongly contributed to the level of storage withdrawals in late 2000, and thus Nicor Gas' lower withdrawals in January 2001 were not the result of an effort to manipulate the GCPP benchmark. *Id.* at 18:319-24.

Dr. Carpenter also describes the market prices at that time—particularly the substantial price spike that occurred in November and December 2000—which further contributed to Nicor Gas' reliance on gas in storage, and which are illustrated by the following graphs taken from Dr. Carpenter's testimony.

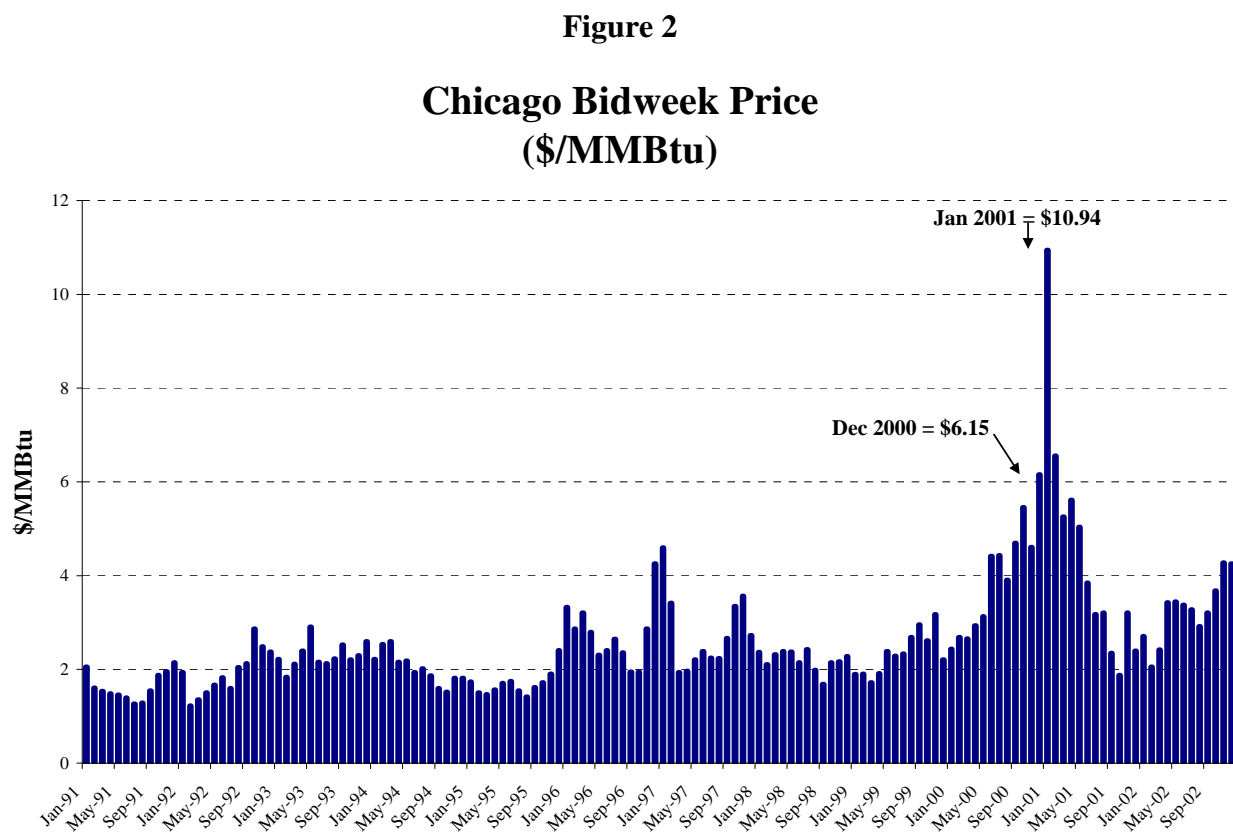


Figure 3
Jan 2001 NYMEX Forward Contract



Source: Bloomberg.

Carpenter Reb., Nicor Gas Ex. 5.0R, 15:296-17:318.

Mr. Effron overlooks these unprecedented high prices, thereby entirely ignoring that they likely contributed to the greater reliance on withdrawals as opposed to market purchases than might otherwise have been expected. Mr. Mierzwa, by contrast, does recognize that the increasing prices in November 2000 gave Nicor Gas an incentive to buy less daily gas and increase storage withdrawals: “I believe the increase in gas prices that were [sic] experienced in November 2000 had a more significant impact in Nicor [Gas’] purchasing decisions.” Mierzwa Reb., CUB Ex. 2.0 Rev., 34:768-70. Nonetheless, in the face of this evidence, Mr. Mierzwa doggedly insists that Nicor Gas’ lower purchases were simply an effort to gain a benefit under

the GCPP by manipulating the benchmark. Carpenter Sur., Nicor Gas Ex. 10.0, 14:249-54 (citing Mierzwa Reb., CUB Ex. 2.0, 34:774-36:803).

Compared with the absence of evidence in the testimony of Messrs. Effron and Mierzwa, Dr. Carpenter provides several figures that compared the price increases in November and December 2000 with pricing in the years 1994 through 1999, also reproduced below.

Figure 2

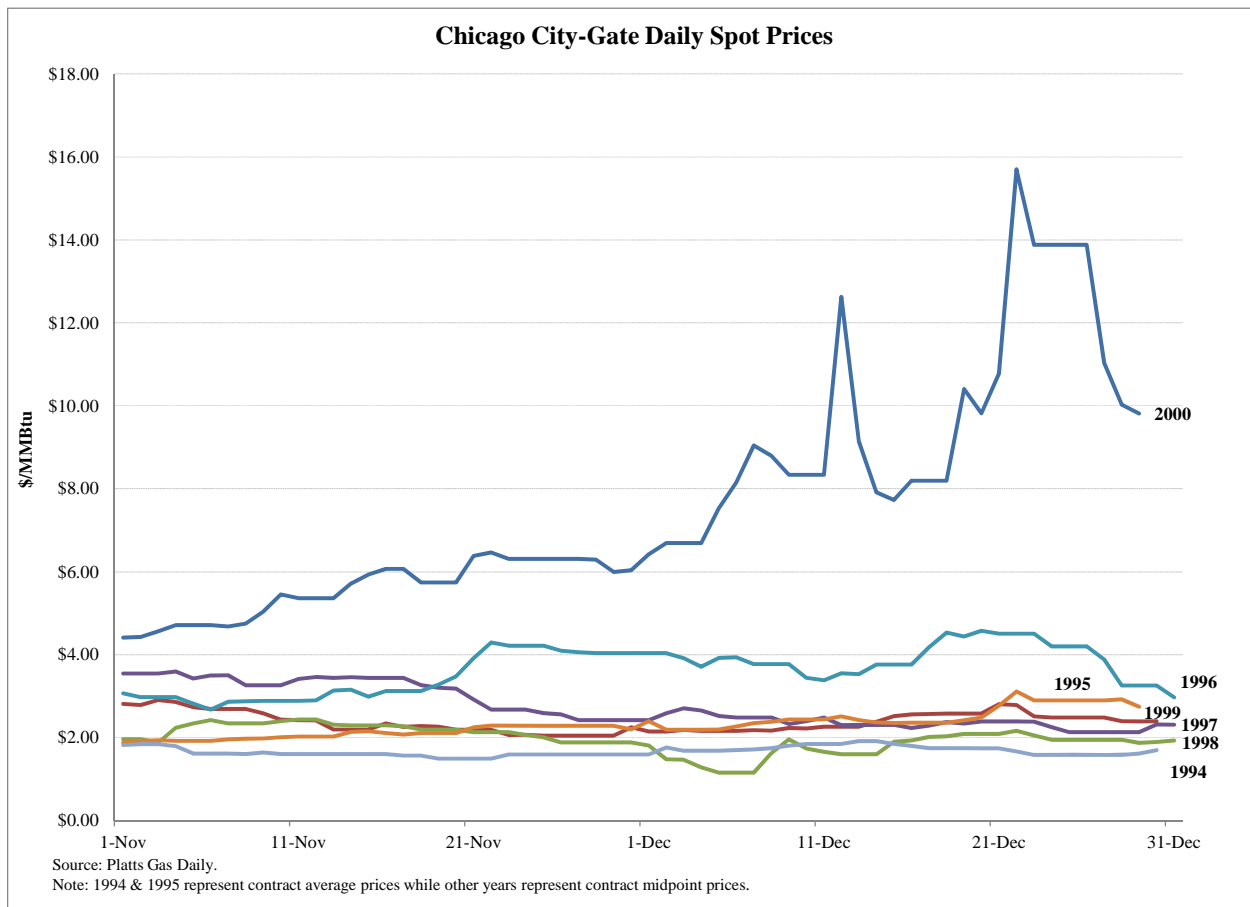
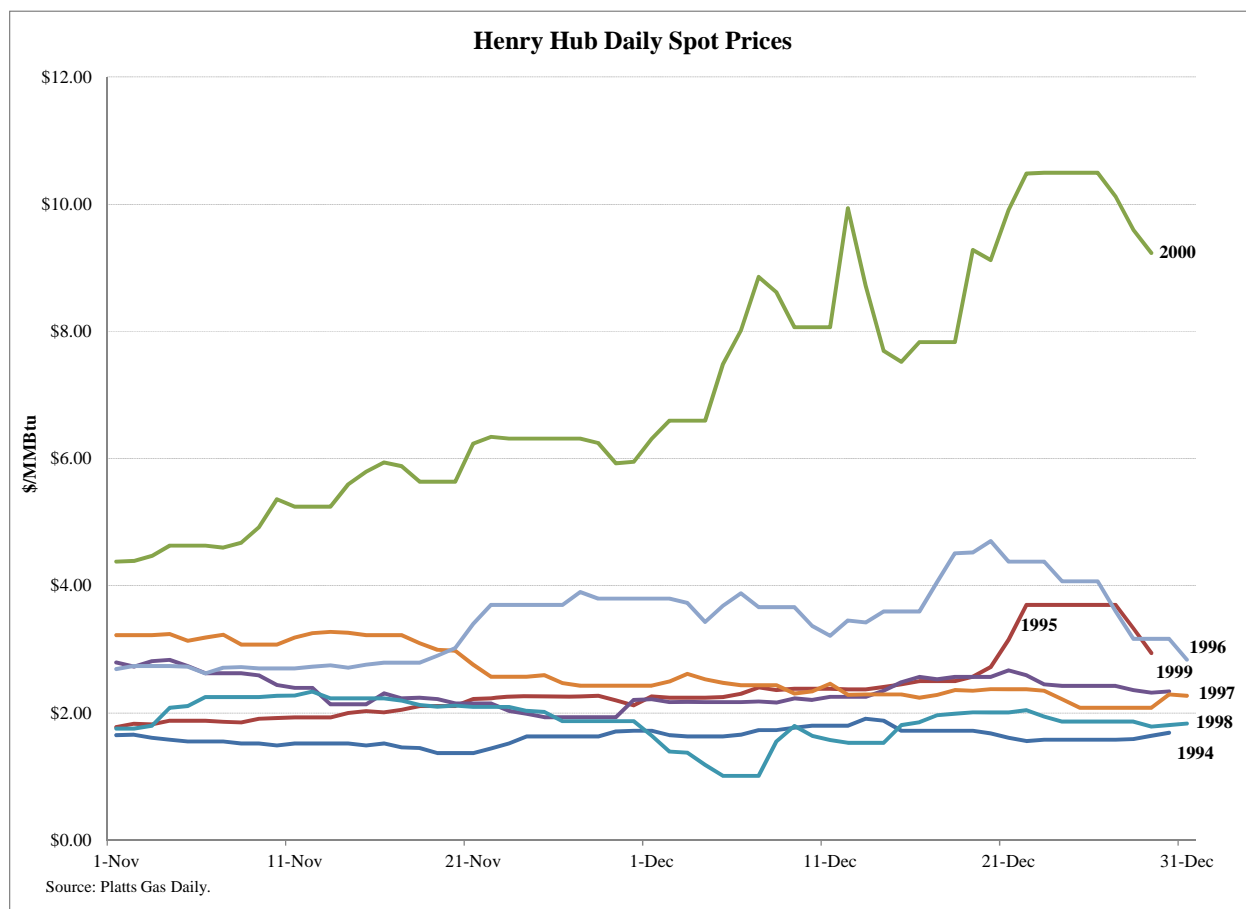


Figure 3

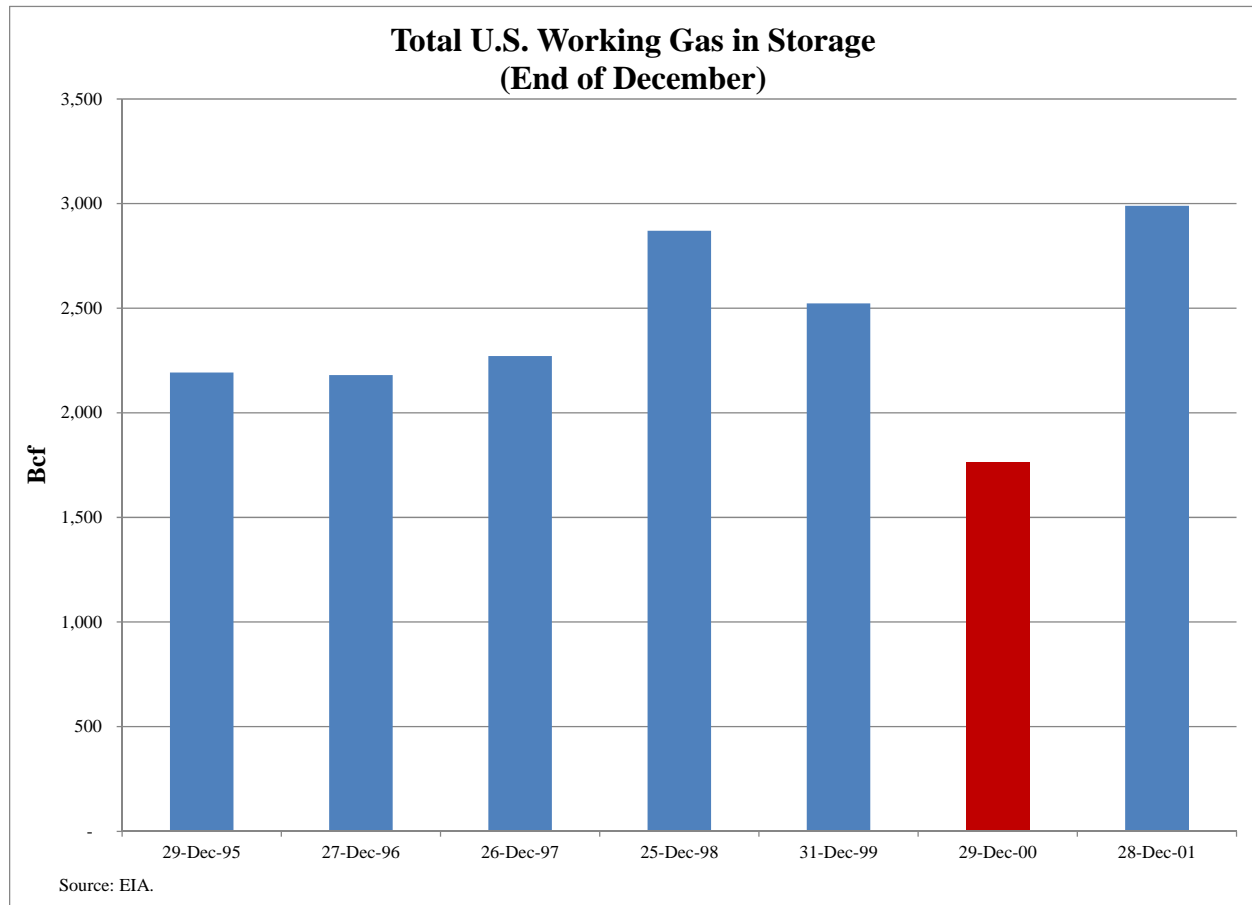


Carpenter Sur., Nicor Gas Ex. 10.0, Figures 2 and 3 at 10:191-11:194. Dr. Carpenter also testified that “the GCPP was not designed or ‘stress tested’ under the price and volatility conditions that prevailed in 2000-2001. Rather, the GCPP was conceived under much less volatile market conditions.” *Id.* at 10:188-90. Unquestionably, greater reliance on withdrawals in the last two months of 2000 allowed Nicor Gas to achieve lower costs for its customers. *Id.* at 12:211-12.

Significantly, these dramatic price spikes led to a rapid drawdown of inventory by gas utilities nationwide, not just by Nicor Gas. Carpenter Reb., Nicor Gas Ex. 5.0R, 18:335-19:386. More specifically, at the end of December 2000, national gas storage inventories were much

lower than normal, and thus Nicor Gas was in a position comparable to the position of gas consumers nationwide. The following graph illustrates this.

Figure 4



Carpenter Sur., Nicor Gas Ex. 10.0, 13:234-37, Figure 4 at 14:245-46. The effect of these spikes on inventory was exacerbated by events earlier in 2000, when expected pricing created a disincentive to fill storage to the same degree as might have existed in previous years.

Mr. Mierzwa, however, did not investigate this absence of economic incentives to fill storage beginning in mid-2000, and thus has no reason to disagree with the proposition that “nationwide storage levels were extremely low due to a lack of economic incentive to fill storage.” Tr.

1212:14-21; Tr. 1215:21-22. He does agree, however, that the 2000-2001 heating season was

characterized by a large decline of underground natural gas storage inventories nationwide. Tr. 1224:14-20.

5. Conclusion

For all the above reasons, any adjustment related to the 2001 “storage cycle” issue would be improper and unlawful. The AG and CUB have presented no credible evidence that Nicor Gas acted improperly in any way. Instead, they rely purely on hindsight speculation and inference. All of the relevant evidence is entirely to the contrary. The proposed AG and CUB refunds based on the 2001 withdrawal cycle should be rejected in their entirety.

F. Tennessee Gas Pipeline and Midwestern Gas Transmission Capacity Costs

The GCPP Benchmark includes a component for transportation costs, the Firm Deliverability Adjustment (“FDA”); generally, the higher the expected costs, the higher the Benchmark. During the course of Docket No. 99-0127, the Commission was well-informed of the existence of ongoing transportation contract negotiations between Nicor Gas and Midwestern Gas Transmission Company and Tennessee Gas Pipeline Company, the outcome of which would affect the FDA. Docket No. 99-0127, Order at 18, 20, 23 (Nov. 23, 1999). The Commission’s Final Order in that docket did not make provision for any post-Order adjustment relating to these contracts, specifically recognizing that “[i]f future events should affect the accuracy of the Firm Deliverability Adjustment, the Commission will be able to revisit the issue soon enough in its two-year review of the GCPP.” *Id.* at 23-24. In this proceeding, Staff witness Maple originally argued that the Commission should adjust the GCPP to reflect the entirety of the discounts obtained by Nicor Gas in 1999 when the contracts were finalized. Maple Dir., Staff Ex. 2.0R, 27:512-28:517 and Table 3. Staff originally claimed that the value of these discounts was \$1,475,267. Zuraski Dir., Staff Ex. 1.0R, 54:1080-81, Att. 1. Even though CUB witness Mierzwa mirrors Mr. Maple’s argument, he proposes a slightly higher adjustment of \$1,495,217.

Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 53:1460-54:1499; CUB Ex. 1.20. The Stipulation between Nicor Gas and Staff fully addresses this issue and Nicor Gas will refund \$1,475,267. Therefore, it is Nicor Gas' position that this issue is moot.

G. Capacity Management Credits

Staff witness Maple originally asserted, and CUB witness Mierzwa followed, the argument that the Company failed to reflect the proper level of capacity management credits that should have been included in the FDA when the Benchmark was established, thereby artificially inflating the Benchmark. Maple Dir., Staff Ex. 2.0R, 35:663-36:685; Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 57:1586-58:1610. To correct for this allegedly improper factor in the calculation of the Benchmark, Mr. Mierzwa proposes adjustments of \$5,893,472 for 2000-2002 and \$3,216,169 for 1999. CUB Exs. 1.22 and 1.23 Rev. The Stipulation between Nicor Gas and Staff fully addresses this issue, and Nicor Gas will refund the exact amount that Mr. Mierzwa claims on these issues. Therefore, it is Nicor Gas' position that this issue is moot.

H. Affiliate Below Market Sale

This issue arises out of Nicor Gas' January 2000 forward sale to its affiliate, Nicor Enerchange, of 2.4 million MMBtu of gas for delivery in September and October 2000. CUB witness Mierzwa argues that this sale was imprudent because it was made at "below-market" prices. Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 58:1612-60:1646. His claim merely repeats an original claim made by Staff, and CUB seeks \$4,258,605 related to this issue. CUB Ex. 1.24. The Stipulation between Nicor Gas and Staff fully addresses this issue, and Nicor Gas will refund the exact amount that Mr. Mierzwa claims on this issue. Therefore, it is Nicor Gas' position that this issue is moot.

I. Aquila Weather Insurance

In the fall of 2000, Nicor Gas sold approximately 3 million MMBtu of gas to Aquila for delivery in March and April 2001. Carpenter Reb., Nicor Gas Ex. 5.0R, 41:799-801; CUB Ex. 1.02 Rev. at 42. In accordance with industry purchase procedures, the price to Aquila reflected the then market price for delivery at those times less a discount to Aquila of about \$2 million; when the gas was actually delivered, the discount to Aquila had increased to over \$6 million. See CUB Ex. 1.02 Rev. at 42-44. Staff witness Zuraski originally recommended a refund to customers of \$3,057,525, reflecting one-half of the difference between the contract price to Aquila and the price prevailing at the time of delivery. Zuraski Dir., Staff Ex. 1.0R, 42:859-44:887 and Table 8. CUB witness Mierzwa recommends an adjustment of \$2,100,000. CUB Ex. 2.03. Both witnesses concede that Nicor Gas has already credited to customers one-half of the discount at the time of purchase (\$1 million) based on the recommendation in the Lassar Report. Zuraski Dir., Staff Ex. 1.0R, 44:888-94; Mierzwa Dir., CUB Ex. 1.0 2nd Rev., 43:1182-85. The Stipulation between Nicor Gas and Staff fully addresses this issue and will refund \$2,057,525. Therefore, it is Nicor Gas' position that this issue is moot.

J. Hub Revenues

As described by Staff witness Zuraski, the Chicago Hub is a name used to identify services offered by Nicor Gas that are not governed by Commission tariffs, but that rely on the Company's access to various natural gas storage and transportation assets in northern Illinois. Zuraski Dir., Staff Ex. 1.0R, 47:957-59. The example Mr. Zuraski provided in testimony is "a gas loan (or reverse parking), whereby Nicor [Gas] loans a quantity of gas to a gas marketer, who brings the same quantity of gas back to Nicor [Gas] at a later date and also pays Nicor [Gas] a monetary fee." *Id.* at 47:959-62. Mr. Zuraski's claim was that certain Hub transactions that he referred to as "multi-cycle" loans were inappropriately treated as utility income rather than being

credited against purchased gas costs in the PGA. Zuraski Reb., Staff Ex. 5.0, 20:412-21:421. He argued that revenues in the amount of \$6,150,917 from these services were not flowed through the PGA even though they should have been. Zuraski Dir., Staff Ex. 1.0R, 49:976-50:1011; 54:1080-81, Att. 1; Staff Ex. 5.2. The Stipulation between Nicor Gas and Staff fully addresses this issue, and Nicor Gas will refund \$6,150,917. No other party raised this topic as an issue in the proceeding. Therefore, it is Nicor Gas' position that this issue is resolved.

K. Refund Allocation

The only refund allocation proposal supported by testimony in this proceeding is set forth in the testimony of Staff witness Mary Everson. Everson Dir., Staff Ex. 3.0, 18:346-19:369. Nicor Gas does not object to Staff's proposal. RESA apparently opposes Staff's proposal, but has offered no testimony suggesting an alternate approach. Accordingly, Nicor Gas reserves its right to respond in its Reply Brief to any RESA proposal set forth in briefs.

IV. CONCLUSION

The evidence demonstrates that the Stipulation entered into between Staff and Nicor Gas, which will result in a refund to customers of \$64 million, is reasonable and should be approved. The Commission should reject the AG and CUB claims for additional refund amounts relating to the 2001 storage cycle, the LIFO carrying costs, and the DSS withdrawals because the AG and CUB have wholly failed to support these speculative claims. In addition, the Commission should

find that all other claims argued by the AG and CUB are rendered moot based upon the Stipulation. Finally, the Commission should grant any other relief the Commission deems appropriate.

Dated: April 6, 2012

Respectfully submitted,

NORTHERN ILLINOIS GAS COMPANY
D/B/A NICOR GAS COMPANY

By: /s/ John E. Rooney

John E. Rooney
John P. Ratnaswamy
Anne W. Mitchell
ROONEY RIPPKE RATNASWAMY LLP
350 West Hubbard Street, Suite 430
Chicago, Illinois 60654
(312) 447-2800
john.rooney@r3law.com
john.ratnaswamy@r3law.com
anne.mitchell@r3law.com

David M. Stahl
EIMER STAHL LLP
224 South Michigan Avenue, Suite 1100
Chicago, Illinois 60604
(312) 660-7600
dstahl@eimerstahl.com

CERTIFICATE OF SERVICE

I, John E. Rooney, hereby certify that I caused a copy of the Initial Brief on behalf of Northern Illinois Gas Company d/b/a Nicor Gas Company to be served upon the service list in consol. Docket Nos. 01-0705, 02-0067 and 02-0725 by email on April 6, 2012.

/s/ John E. Rooney

John E. Rooney